

## Instructions for Schedule H (Form 1120-F)

### Deductions Allocated to Effectively Connected Income Under Regulations Section 1.861-8

#### General Instructions

**Section 1.861-8 – in general.** A foreign corporation's deductions are deductible against its U.S. taxable income only if they are connected with income effectively connected with the conduct of a trade or business in the United States. Under section 882(c), all foreign corporations must apply Regulations section 1.861-8 to determine the allocation and apportionment of general and administrative expenses. Under the regulation, expenses not directly related to a statutorily determined class of gross income (enumerated under Code section 61) must of necessity be allocated to all classes of income by a methodology which relates each of these classes of gross income to the total. Classes of gross income are described in section 1.861-8(a)(3). Deductions in each class of gross income are apportioned between Statutory and Residual groupings of income. Schedule H apportions the expenses factually related to each class of income to the Statutory Grouping which is ECI and the Residual Grouping that is non-ECI. See regulations section 1.861-8(a)(4) and Temporary regulations section 1.861-8T(c).

#### Purpose of Schedule

Schedule H (Form 1120-F) reports the foreign corporation's allocation and apportionment deductions (other than interest expense) to its income effectively connected ("ECI") with its trade or business within the United States under Regulations section 1.861-8 and Temporary regulations section 1.861-8T. Schedule H includes the allocation and apportionment of research and experimentation expenditures which section 1.861-8 subjects to the rules of section 1.861-17. Schedule H also includes the allocation and apportionment of charitable contributions that are specifically covered under section 882(c)(1)(B). These instructions refer to all of the allocations and apportionments by reference to section 1.861-8. The results reported on Schedule H are included on the corporation's income tax return on Form 1120F, Section (page 3 of Form 1120F).

Schedule H is in four Parts. **Parts I and II – Lines 1 through 21.** Parts I and II of Schedule H identify, allocate and apportion, the corporation's pool of deductions under regulations section 1.861-8, recorded on the corporation's set(s) of books that are not reportable on Schedule L of Form 1120-F. These books are generally referred to as the corporation's home office books although the deductions allocable to ECI may derive from locations outside the United States other than in the corporation's home country. The total allocation of deductions to ECI from the home office books is reported in Part II, line 19. Deductions allocated to ECI from from non-Schedule L books in locations other than the home office are reported in Part II, line 20. Deductions allocable to ECI from set(s) of books that are

reportable on Schedule L (Form 1120-F) are generally referred to as the books of the corporation's trade or business within the United States or the books of the U.S. branch, although certain set(s) of books may be maintained in a location outside the United States and be reportable on Schedule L because under the facts and circumstances, such books record the income with respect to substantial activities that give rise to ECI. See the instructions to Form 1120-F, Schedule L for further discussion.

**Part I – Deductions Directly Allocated and Apportioned to ECI and non-ECI.**

Part I identifies the expenses of the non-Schedule L books, adjusts the expenses for eligible deductibility under U.S. tax principles and for inclusion in the eligible pool of deductions that allocate and apportion under regulations section 1.861-8. The schedule reports the amount of the deductions that are allocable and directly apportioned to ECI and non-ECI under section 1.861-8. The determination of these deductions and direct allocations and apportionments are reported on lines 1 through 14.

**Part II – Home Office Deductions Indirectly Allocated and Apportioned to ECI and non-ECI.** Part II provides reporting of the corporation's indirect allocations and apportionments to ECI and non-ECI with respect to the remaining expenses not directly allocated in Part I. These indirect allocations and apportionments are reported on lines 15 through 20. The total home office allocation to ECI is reported on line 21 and on Form 1120F, Section II, line 26.

**Part III – Indirect Allocation and Apportionment Methods and Financial Records.** Part III identifies the ratio methods the corporation uses to allocate and apportion deductions indirectly in Part II between ECI and non-ECI. The indirect methods are identified in lines 22 through 26. Lines 27 through 29 identify the types of home office records (e.g. financial statements, management cost accounting reports) the corporation used in identifying and making the allocations and apportionments to ECI and non-ECI.

**Part IV - Allocation and Apportionment of Deductions on Books and Records Used to Prepare Form 1120-F, Schedule L. Lines 30 – 42.** Part IV identifies the deductions on the corporation's sets of books reported on Schedule L (other than interest expense and bad debt deductions) and reports the allocations and apportionments to ECI that are also includable on Form 1120F, Section II other than on line 26. Lines 39 through 42 reconcile the eligible amount of deductions on the Schedule L books with the direct and indirect apportionments between ECI and non-ECI.

**Reporting Corporation**

A reporting corporation is any foreign corporation engaged in a trade or business or treated as engaged in trade or business within the United States directly or indirectly at any time during the taxable year.

**Other Forms and Schedules Related to Schedule H (Form 1120-F)**

- **Form 1120-F, Schedule L.** The set(s) of books and records reportable on the Schedule L balance sheet on Form 1120-F, are the same set(s) of

books and records from which deductions allocated and apportioned between ECI and non-ECI on Schedule H, Part IV (lines 30 – 42) are derived. See instructions for Form 1120-F, Schedule L on pages 25 – 27.

- **Schedule M-3 (Form 1120-F), Part II, line 25 and Part III, line 31.** The gross income ratio included in Part III of this Schedule H derives its worldwide gross income for non-bank corporations from the worldwide gross income reported in Part II, line 25, column (a). Effectively connected income is derived from Part II, line 25 column (e) for all Schedule M-3 filers. The total deductions allocated and apportioned to ECI from the home office set(s) of books is reported on Schedule M-3 (Form 1120-F), Part III, line 31, in columns (d) and (e).
- **Schedule I (Form 1120-F), Line 6b.** The worldwide gross assets ratio identified in Part III of this Schedule H, derives its U.S. assets amount from Schedule I, line 5(d) and the worldwide average number for certain taxpayers from Schedule I (Form 1120-F), line 6b. See instructions to line 23b, below.

### **Who Must Complete**

All foreign corporations engaged in trade or business within the United States, filing Form 1120-F must complete Schedule H and attach it to the Form 1120-F that it is filing for the taxable year.

### **Exceptions from filing Schedule H**

A foreign corporation is not required to file Schedule H if it does not have a trade or business within the United States. **Protective returns.** If the corporation has limited activities in the United States in a taxable year which it determines does not give rise to gross income effectively connected with a trade or business within the United States, or, it does not give rise to business profits attributable to a U.S. permanent establishment, the corporation may timely file a protective tax return for purposes of preserving its right to claim deductions if it is later determined after the return was filed that the corporation's original determination was incorrect. On the protective return, the corporation does not have to enter income and deductions on the Form. See Regulations section 1.882-4(a)(3)(vi). When a protective return is filed, do not complete or attach Schedule H to the Form 1120-F. See instructions for filing protective returns on Form 1120-F, pages 9 and 10.

**Treaty-based return reporting of business profits attributable to a U.S. permanent establishment.** Do not complete Schedule H (Form 1120-F) If the corporation files its income tax return to report business profits attributable to a U.S. permanent establishment under OECD Transfer Pricing Guidelines principles. Treaty-based reporting other than under the ECI rules of sections 882(a) and the allocation of expense provisions under section 882(c) is permitted only if the applicable treaty provision and accompanying documents (such as Exchange of

Notes) expressly provides that attribution of profits is determined pursuant to the OECD Transfer Pricing Guidelines. See Article 7 and the accompanying Exchange of Notes to the 2001 United States-United Kingdom and 2003 United States-Japan Income Tax Treaties. See instructions to Schedule M-3 (1120-F) for the reporting of book tax differences in Parts II and III under a treaty-based method pursuant to application of the OECD Transfer Pricing Guidelines principles in lieu of the ECI and expense allocation rules.

## **Record Name and Employer Identification Number at the Top of Each Page**

### **Specific Instructions by Line Item**

#### **Part I - Deductions Directly Allocated and Apportioned to ECI and Non-ECI**

Part I identifies the pool of expenses other than interest expense, bad debts, research and experimentation expenses and charitable contributions on the corporation's home office books and reports the corresponding amount that qualifies as a deduction under U.S. tax principles. Part I is also used to report the portion of the deductions on the corporation's home office books that are directly allocated and apportioned to ECI and non-ECI. Part I may be completed in U.S. dollars or in the corporation's functional currency. If the corporation uses the functional currency it must be translated and reported in U.S. dollars.

**Identification of currency used to report direct allocations in Part I. Check Box:** If the corporation reports its direct allocations in U.S. dollars, check the box above line 1. If the corporation reports its direct allocations in its foreign functional currency, specify the currency in the space above line 1 where indicated.

#### **Line 1. Total Expenses on the Books of the Home Office**

Enter on line 1 the total expenses on the books and records of the home office. The books and records may be audited or unaudited financial statements. If the financial statements used include expenses of consolidated entities that are not deductions under U.S. tax principles of the corporation filing the Form 1120-F, then such expenses must be adjusted from the eligible pool of deductions on line 2. Alternatively, the books and records used may be other home office records (e.g. management cost accounting reports) that identify the expenses included in the corporation's financial statements for the taxable year. The home office books may be books recorded under the Generally Accepted Accounting Principles ("GAAP") of the rules applicable to the corporation's accounting practices or under U.S. GAAP at the corporation's choosing. If the corporation does not consolidate its home office expenses with the expenses of other includible entities (i.e., disregarded entities) that are treated as deductions of the corporation filing the Form 1120-F for the taxable year, the books and records of the corporation and

the disregarded entity may be different if necessary to identify the corporation's overall eligible pool of expenses under U.S. tax principles. For instance, if the corporation uses management cost accounting statements for its home office books and certified audited third-country GAAP statement for one or more disregarded entities, the expenses of the disregarded entity must be included in either U.S. dollars or the home office's functional currency even if the audited statements under third-country GAAP are in another non-U.S. functional currency. Part III identifies the various types of statements used to report the expenses included in line 1.

**Line 2. Adjustments for U.S. Tax Principles (Attach Schedule)**

Enter on Line 2 the adjustments necessary to conform the items and amounts on line 1 to the amounts that constitute deductions under U.S. principles that are subject to allocation and apportionment under Regulations section 1.861-8 and Temporary regulations section 1.861-8T. Line 2 also includes any expenses reported on line 1 of consolidated entities whose income and expense are not includible in the corporation's income and expenses for tax purposes. Adjustments of this type are the same as those made for expenses of nonincludable companies that are eliminated in determining the corporation's nonconsolidated financial net income on Schedule M-3 (Form 1120-F), Part I line 7. See instructions for determining the nonconsolidated foreign corporation's financial net income (loss) in Schedule M-3, Part I. Other adjustments include temporary and permanent differences of the type applicable to determining the deductions of U.S. corporations that file their income tax returns on Form 1120. Attach a schedule indicating the amounts for each category of adjustment the corporation makes on line 2 to establish the eligible pool of allocable deductions under U.S. tax principles. Do not include any allocations or apportionments to non-ECI as adjustments on line 2. Further do not adjust for amounts that are subject to disallowance for allocations to tax-exempt income or for deferrals under other sections of the Code such as section 267. Report the adjustments on the attached schedule in the following format:

Category	Amount of Adjustment
1. Expenses in Line 1 not includable in the corporation's nonconsolidated financial net income	
2. Temporary Differences: e.g. Depreciation and amortization, loan loss reserves	
3. Permanent Differences: e.g. Meals and Entertainment, Non-deductible executive salary compensation.	

**Note: *Special treatment of interest expense.*** Provisions of the Code (e.g. section 163(e), 163(j), 263A, 265) that defer or disallow interest expense are applied after application of section 1.882-5. Do not make these adjustments on line 2 for any interest expense included in line 1. Interest expense is adjusted and reported on Schedule I (Form 1120-F). ***Treatment of loan losses.*** Adjustments for loan losses and book loss reserves are made on line 2 to determine the amount bad debt loss that is deductible under U.S. tax principles. If a bank treats any amount of bad debt expense included in line 1 as an involuntary charge off under section 1.166-2, such amount is treated as a temporary difference on line 2 and eliminated from the eligible pool of deductions for the current taxable year. The deductible amount remaining after any adjustments on line 2 is not allocated and apportioned on Schedule H but is eliminated on line 5. Any amount that is allocable to ECI with respect to the amount eliminated on line 5, is reported directly on Form 1120-F, Section II, line 15. See instructions to Form 1120-F, Section II for additional disclosures for loan losses exceeding \$500,000 that are allocated and apportioned to ECI.

**Line 3. *Total Adjusted Expenses on the Books of the Home Office***

Combine lines 1 and 2 and enter the result on line 3. The amount reported on line 3 constitutes the total amount of deductions (determined under U.S. tax principles) of the nonconsolidated corporation that files Form 1120-F, that are not included on the corporation's Schedule L books.

**Line 4. *Interest Expense (Included in Line 3)***

Enter on line 4, the total amount of interest expense (if any) included in line 3. Interest expense is allocable ECI under Regulations section 1.882-5 and 1.882-5T and reported on Schedule I (Form 1120-F).

**Line 5. *Bad Debt Expense (Included in Line 3)***

Report on line 5 the bad debt expense included in line 3 above. This is the amount of the expense that constitutes a partial or wholly worthless bad debt under section 166 of the Code for which a reduction to the tax basis of the asset occurs in the current taxable year under U.S. tax principles. Bad debt expense is allocated and apportioned under the regulations section 1.861-8 and are deductions definitely related to the class of income and statutory ECI or residual non-ECI grouping of income generated by the debt and directly apportioned on that basis. However, the apportionment is not reported on Schedule H. The ECI apportionment is reported exclusively on Form 1120-F, Section II, line 15.

**Line 6. *Total of Interest & Bad Debt Expense (included in Line 3)***

Add lines 4 and 5 and enter the amount on line 6.

**Line 7. *Remaining Deductions from Line 3 (Line 3 minus Line 6)***

Subtract line 6 from line 3 and enter the amount on line 7. This is the total of the remaining home office deductions adjusted to U.S. tax accounting principles which

are eligible for allocation and apportionment between ECI and non-ECI under Regulations section 1.861-8 (including research and experimentation expenditures that are allocated and apportioned under section 1.861-17). Only the ECI portion of the amount on line 7 is deductible in the United States against effectively connected taxable income. **Note:** The portion that is allocated and apportioned to ECI may be subject to additional deferrals or disallowances under other provisions of the Code. Further allocation and apportionment to the portion of ECI that is tax-exempt income under section 265 or to the portion of ECI that is exempt under an applicable income tax treaty (e.g. expenses allocable to income that is ECI under the force of attraction principle of section 864(c)(3) but is not attributable to a U.S. permanent establishment), may be reportable under the facts and circumstances on either Part I, line 10 as a direct allocation, or as an indirect allocation and apportionment in Part II, line 17. See instructions for lines 10 and 17, below.

**Direct Allocations and Apportionments of Home Office Deductions to Noneffectively Connected Income: Lines 8 through 10:**

**Note:** The deductions that are includable on lines 8 through 10 (and on line 13, below) are those that are specifically identifiable (i.e. definitely related) with a class of income and the Residual Grouping of non-ECI under section 1.861-8. The amounts directly allocable to particular classes are subject to apportionment between ECI and non-ECI. The non-ECI apportionments of such specifically identifiable deductions are reported on lines 8 through 10.

**Line 8. *Deductions Directly Allocable to Noneffectively Connected Income from Subsidiaries.***

Enter on line 8 deductions from line 7 that are directly allocable and apportionable to non-ECI dividend income received from entities (other than disregarded entities whose net income or loss is treated as the net income or loss of the corporation filing Form 1120-F). Deductions on the home office books are treated as definitely related and therefore directly allocable to dividends from subsidiaries under the facts and circumstances. See regulation section 1.861-8(e)(4) and Temporary regulations section 1.861-8T(e)(4). The corporation need only identify the amount of such direct allocation to non-ECI subsidiary income on line 8 and need not identify with the Schedule H, how the amount reported on line 8 was determined.

**Line 9. *Deductions Directly Allocable to Other Noneffectively Connected Income Booked in the Home Country.***

Enter on line 9, the amount from line 7 directly allocable and apportionable to non-ECI (other than allocations to non-ECI from subsidiaries that are reportable on line 8) and that is booked in the corporation's home country of residence. The amount reported on line 9 includes allocations to non-ECI income recorded on sets of books from activities in the home office as well as to non-ECI recorded from other operations in other locations in the corporation's home country. For example, line 9 includes deductions from line 7 directly allocable and apportionable to a banking corporation's non-ECI recorded in its retail banking branches in the corporation's

country of residence. Line 8 is also used to report deductions directly allocated and apportioned to the non-ECI income from the corporation's wholesale banking operations conducted and recorded in the corporation's home office. The Line 9 allocations and apportionments to non-ECI are determined under the facts and circumstances under section 1.861-8. The amount of any inter-office or interbranch charges from the home office to various locations and departments that relate to deductions recorded on the home office books as home office "service" fees for internal management or home office tax accounting purposes is not determinative of the amount allocable and apportionable to non-ECI under the requirements of section 1.861-8. Similarly, interoffice and interbranch fees paid from the home office to other departments and locations in the home country for internal services rendered by such other business units or offices is not determinative of the home office deduction amount from line 7 that is reportable on line 9.

**Line 10. Deductions Directly Allocable to Other Noneffectively Connected Income Booked in Other Countries (Including the United States). (Attach Schedule).**

Report on line 10, deductions included on line 7 that are directly allocable and apportionable to non-ECI that is booked in all locations other than the corporation's home country of residence. Attach a schedule to line 10 to indicate the amount of direct allocation and apportionment entered line 10 made to each location outside the corporation's country of residence (including the United States). If direct allocations are made to non-U.S. locations but no direct allocation and apportionment is made to the United States, the schedule must still be attached to reconcile the total amount entered on line 10 with the amounts allocated to the other foreign locations. For example, if corporation conducts global banking operations through branch offices (or through disregarded entities) in various economic and geographic sectors, the home office deductions included on line 7, that directly relate to non-ECI earned in the foreign locations outside the home country of residence, are reportable on line 10. Direct allocations and apportionments to non-ECI may include apportionments to non-ECI from disregarded entities whose income is treated as the corporation's directly owned income under U.S. tax principles whether or not the balance sheet from such entity is reportable on Schedule L of Form 1120-F. For corporations other than banks, such non-ECI may be reflected as income from includable entities on Part I, line 5 of Schedule M-3 (Form 1120-F). Foreign banks record such non-ECI on Part I, line 5 of Schedule M-3 as an includable disregarded entity only if the entity's sets of books are reportable on Form 1120-F, Schedule L. See instructions to Schedule M-3 (Form 1120-F), Part I. **Do not include on line 10**, any amounts allocable to dividends from subsidiaries that are reportable on line 8.

**Tax-exempt and treaty-exempt allocations.** If the corporation has deductions included in line 7 that are directly allocable to tax-exempt or treaty exempt ECI, the deductions may be treated for reporting purposes on Schedule H the same as deductions that are directly allocable and apportionable to non-ECI, and may be



included in the amount entered on line 10. If the corporation chooses to report the allocation and apportionment of deductions to tax-exempt and treaty-exempt ECI separately from reporting the additional allocation of the ECI deduction between taxable and non-taxable ECI, then the deduction must be allocated first to ECI on either line 12 (or if indirectly allocable, on line 17) and included in the overall deduction reported on line 21 and Form 1120-F, line 26. However, the amount included on Section II, line 26 must be reduced by reversing the portion that allocates to tax-exempt or treaty-exempt income on Form 1120-F, Section II, line 27 ("Other Deductions" line). The reduction is reported on Form 1120-F, Section II, line 27 as a negative amount and must be identified in the line 27 attachment that lists all other deductions included on that line.

**Line 11. Subtotal: (Add Lines 8 through 10)**

Add lines 8, 9 and 10 and enter the total on line 11. The amount on line 11 constitutes the total portion of deductions on line 7 that are directly allocated and apportioned to the corporation's non-ECI.

**Line 12. Remaining Expenses on the Books of the Home Office Allocable under section 1.861-8**

Subtract line 11 from line 7 and enter the amount on line 12. The amount on line 12 is the residual portion of deductions on line 7 that are eligible for allocation and apportionment to ECI using both direct and indirect methods under section 1.861-8.

**Line 13. Less: Deductions Directly Allocated to Effectively Connected Income.**

Enter on line 13 the portion of deductions reported on line 12 that are directly allocated and apportioned to ECI under the facts and circumstances under section 1.861-8. The corporation need not provide details on Schedule H of the items that constitute the direct allocation to ECI. Deductions directly allocable and apportionable to ECI may include specifically identifiable personnel and other associated costs incurred in the home office with respect to persons who work on the evaluation and approval of effectively connected income producing activities of the corporation's trade or business within the United States (e.g., specifically identifiable home office deductions incurred for the evaluation and approval of U.S. loans to customers negotiated and solicited by the corporation's U.S. branch office). Charitable contributions included in line 7, that are deductible under section 170, are deductible under section 882(c)(1)(B) and reportable on line 13.

**Line 14. Remaining Deductions on the Books of the Home Office Indirectly Allocable under section 1.861-8**

Subtract line 13 from line 12 and enter the amount on line 14. The amount on line 14 is the residual amount of the general and administrative deductions from line 7 that are not definitely related to a class of gross income or are deductions that relate to all income of the corporation. See regulations section 1.861-8(b)(5) and

(c)(3), and Temporary regulations section 1.861-8T(b) and (c). The amount on line 14 is subject to allocation and apportionment under indirect methods in Part II, line 17, below.

**Part II - Home Office Deductions Indirectly Allocated and Apportioned to ECI and non-ECI**

**Line 15. Average Exchange Rate Used to Convert Allocable Deductions to U.S. Dollars.**

If the corporation reports expenses and deductions in Part I, lines 1 through 14 in the corporation's foreign functional currency, enter the average exchange rate used to convert the allocable deductions in Part I to U.S. dollars. If the corporation reports Part I in U.S. dollars, leave line 15 blank.

**Line 16. Deductions Indirectly Allocable Under Regulations Section 1.861-8 (in U.S. dollars).**

Enter on line 16, the amount from line 14 in U.S. dollars. If the amount on line 14 is stated in the corporation's functional currency (other than the U.S. dollar), multiply line 14 by the line 15 exchange rate and enter the amount on line 16.

**Line 17. Indirect Allocation and Apportionment of line 16 amount to ECI (attach computation)**

Enter on line 17 the amount from line 16 that is allocated and apportioned to ECI under indirect methods. Attach a schedule showing the indirect methods used and the amount allocated under each method to ECI. If the corporation uses an average of different indirect methods with respect to the allocation and apportionment of a pool of costs, show each indirect method in the determination of the average. If separate allocations are made for research and experimentation expenditures, indicate on the attached schedule the separate poolings of deductions from line 7 that were allocated under section 1.861-17 and the separate methods used to make such allocations and apportionments to ECI.

**Line 18. Deductions Directly Allocated to ECI from Line 13, in U.S. Dollars.**

Enter on line 18, the amount of the corporation's direct allocation of deductions from line 13, in U.S. dollars. If the amount on line 13 is stated in the corporation's foreign functional currency, multiply line 13 by line 15 and enter the amount on 18. Multiply line 13 by the line 15 exchange rate.

**Line 19. Total Home Office Deductions Allocated to Effectively Connected Income**

Add lines 17 and 18 and enter the amount on line 19. The amount on line 19 is the total amount of deductions on the home office books allocated to ECI.

**Line 20. Total Deductions from Other non-U.S. Locations Allocated and Apportioned to Effectively Connected Income (attach schedule)**

If the amount on line 7 includes deductions from only the books of the home office and does not include deductions from other non-Schedule L books in other locations, enter on line 20 in U.S. dollars, the amount of deductions allocated and apportioned to ECI from such foreign locations other than the home office. The amount on line 20 includes deductions allocated both directly and indirectly to ECI. Attach a schedule to Schedule H indicating the amount of deduction allocated and apportioned to ECI from each location. Indicate both the direct and indirect allocations from each location. **Note:** If the deductions included in line 7 include deductions from all non-Schedule L books including those from locations outside of the home office, line 20 must be left blank to avoid double counting of the allocations and apportionments.

**Line 21. Total Deductions Allocated and Apportioned to Effectively Connected Income**

Add lines 19 and 20 and enter the amount on line 21. The amount entered on line 21 is the total deduction allocated and apportioned to ECI from the corporation's non-Schedule L books. The amount is also reported on Form 1120F, section II, line 26 and on Schedule M-3 (Form 1120-F), Part III, line 31.

**Part III: Indirect Allocation and Apportionment Methods and Financial Records (Lines 22 through 29)**

Part III is used to report the corporation's effectively connected attributes included in its indirect allocation methods and to identify the types of financial records used to determine the expenses and deductions eligible for allocation and apportionment in Parts I and II of Schedule H. Lines 22 through 24 provide for reporting the corporation's effectively connected proportion of worldwide gross income, gross asset and personnel attributes. Lines 25 and 26 provide for the disclosure of other ratio based methods the corporation used for the taxable year and any other non-ratio based methods the corporation applied to allocate and apportion costs to ECI.

**Check Boxes**

**New Methods:** Check the box to indicate if the corporation used a method for the current taxable year that was not used in the prior year to allocate and apportion deductions.

**Interbranch Amounts in Part IV:** Check the box to indicate if any amounts included in the home office allocation in Part II, line 21 was also recorded on the Schedule L books that are reported in Part IV of this Schedule H. Identify such amount in Part IV on line 36. See instructions, below.

**Lines 22 through 24 (Gross income, Gross Asset and Gross Personnel Ratios)**

The corporation must complete the gross income ratio for line 22 whether or not it used such method to allocate and apportion deductions in Parts I and II. If the corporation used a gross asset or gross personnel method (whether separately or as components of a multi-factor method), it must include the attributes in lines 23 and 24 as specified in the instructions. If the corporation does not use either of the gross asset or personnel methods to allocate and apportion deductions for the year, then except as provided for line 23b, only the numerators of each method need be completed in accordance with the instructions in lines 23 and 24. See special instructions in line 23(b) for disclosure of the gross asset ratio by corporations that use the actual ratio to allocate interest expense under section 1.882-5.

**Line 22. Gross Income Ratio.**

**Line 22a. Effectively Connected Gross Income.** Enter on line 22a, the corporation's gross ECI reflected on Schedule M-3 (Form 1120-F), Part II, line 25, column (e). If the corporation is not required to and does not file Schedule M-3 (Form 1120-F) for the taxable year, enter the amount of gross income from Form 1120-F, Section II, line 12. **Note:** Enter the gross income as indicated in this line 22 instruction regardless of whether the corporation uses a different amount of ECI in a gross income ratio method identified in Part II, line 17.

**Line 22b. Worldwide Gross Income.**

Enter on line 22b, the corporation's worldwide gross income stated in U.S. dollars on line 22b. For corporations other than banks, enter the gross income amount from Schedule M-3 (Form 1120-F), Part II, line 25, column (a) regardless of whether the corporation uses a different worldwide income amount in a gross income ratio method identified in part II, line 17. If the non-bank corporation is not required to and does not file Schedule M-3 (Form 1120-F) enter the worldwide gross income amount used (if applicable) for the year in a gross income ratio in Part II, line 17. Only If neither is available, the corporation may enter on line 22b, the worldwide gross income from the corporation's worldwide financial statements that would be identified in Schedule M-3 (Form 1120-F) if the corporation did file Schedule M-3 for the year. See instructions to Schedule M-3 (Form 1120-F) for the selection of the applicable financial statement, including the permissible use of the corporation's worldwide trial balance if a prepared financial statement is unavailable. **Foreign banks.** Foreign banks that are described in Temporary regulations section 1.882-5(c)(4), enter on line 22b, the worldwide gross income included in a gross income ratio used to allocate and apportion deductions entered in Part II, line 17. If no gross income ratio was used to allocate deductions in Part II, enter the worldwide gross income from any other reasonable source including the worldwide income statements that would be used to complete Schedule M-3 (Form 1120-F) if the corporation was not a bank. Banking corporations may use

the worldwide gross income number used to report allocations of income or capital to other regulatory or non-Federal tax authorities.

**Line 22c. Gross income ratio.** Divide line 22a by line 22b and enter the percentage on line 22c.

#### **Line 23 – Gross Asset Ratio**

**Line 23a. Average U.S. Assets from Schedule L, line 5, column (d).**

Report on line 23a, the average assets reported on Schedule I (Form 1120-F), line 5(d). These are the average U.S. assets included in the corporation's section 1.882-5 interest expense allocation. If the corporation does not have any interest expense for the year and does not file Schedule I (Form 1120-F), enter the average assets derived from the beginning and ending U.S. assets included in the computation of U.S. net equity on Form 1120-F, Page 5, Section III, Part A, lines 4a and 4b. If the corporation is exempt from the branch profits tax under an applicable income tax treaty and does not complete Form 1120-F, page 5, Section III, Part A, the average U.S. assets should be derived from the U.S. assets included on Schedule L, Form 1120-F for the beginning and year-end.

**Line 23b. Average Worldwide Assets (from Schedule I, line 6b if applicable).**

If the corporation uses the worldwide actual ratio under section 1.882-5(c)(2) to allocate interest expense to ECI, enter the amount from Schedule I, line 6b. If the corporation does not use the actual ratio under section 1.882-5(c)(2), but uses a gross-asset allocation ratio to allocate and apportion deductions to ECI in Part II, line 17 of this Schedule H, enter the worldwide assets used in the ratio. If a worldwide asset ratio is not available from Schedule I, line 6b or Schedule H, line 17, leave line 23b blank.

**Line 23c. Gross Asset Ratio.** If an amount is entered for line 23b, divide line 23a by line 23b and enter the percentage on line 23c. If an amount is not entered on Schedule I, line 6b or used to allocate deductions in Part II, line 17, leave line 23b blank.

#### **Line 24. Number of Personnel.**

**Line 24a. Personnel of U.S. trade or business within the United States.** Enter on line 24, the number of personnel who worked in the United States trade or business for the taxable year. If the corporation uses a gross personnel count ratio (whether separately or as part of a multi-factor formula) to allocate deductions in Part II, line 17, the corporation may use the numerator of such ratio for reporting on Line 24a. If the corporation does not use a personnel ratio to allocate deductions in Part II, line 17, then the number of personnel is derived first by reference to the personnel whose salaries and employee benefits are included on the Schedule L books reported in Part IV of this Schedule H. The corporation may

use any reasonable approach to determining the number of personnel for which data is reasonably available including data that is already prepared and used by the corporation for a non-tax business purpose. For example, if the corporation maintains weighted average headcount data in its personnel records or for other purposes such as budgeting, planning and control, such weighted average amounts may be used in the numerator. If personnel in the United States work for a service subsidiary that is not included in the Schedule L books reported in Part IV, then include the personnel count of such subsidiary in the numerator if the costs of the subsidiary are charged back as a service fee to the corporation and such amount is recorded on the Schedule L books and records or allocated and apportioned to ECI and reported in Schedule H, Part II, line 21.

**Line 24b. *Worldwide personnel of the foreign corporation.*** If the corporation uses a gross personnel count ratio to allocate deductions in Part II, line 17 (whether separately or as part of a multi-factor formula), enter the worldwide personnel count used in the denominator of such ratio on line 24b. If the corporation does not allocate deductions in Part II, line 17 using a personnel ratio, the corporation may leave line 24b blank.

**Line 24c. *Number of Personnel Ratio.*** If the corporation enters an amount on line 24b, divide line 24a by line 24b and enter the percentage on line 24c. If the corporation does not enter an amount on line 24b, leave line 24c blank.

**Line 25. *Other Ratio Based Methods (Attach Schedule)***

If the corporation uses any other ratio based methods to allocate and apportion deductions on line 25, attach a schedule and indicate the amount of the numerator and denominator for each ratio and a description of each. (e.g. number of loans reviewed that are U.S. assets over the total number of loans reviewed, number of publications distributed to the U.S. office divided by the total number of publications distributed, etc.). If separate ratio based methods are used to allocate and apportion research and experimentation expenditures, identify the methods used under section 1.861-17.

**Line 26. *Other Methods (e.g. Time Spent Analysis) Attach Schedule***

Please indicate whether one or more indirect allocation methods were used other than those derived from separate attributes that create "ratio based". Attach a schedule describing each method including whether such methods are used to allocate and apportion expenses between ECI and non-ECI in Part IV of this Schedule H. Allocation methods may include time spent methods (e.g. 10-percent of time spent from particular home office departments or sub-departments on U.S. trade or business activities). List the methods used separately for home office based allocation methods and for ECI or non-ECI methods used to apportion deductions at the trade or business level. If other methods are separately used to allocate and apportion research and experimentation expenditures, identify the methods used under section 1.861-17.

**Identification of Financial Records Used (Lines 27 through 29 – attach schedule)**

Check either the “yes” or “no” box if the following financial books and records were used in the allocation computation. Check all that apply:

**Line 27a. *Published or Other Non-Public Audited Financial Statements***

**Line 27b. *Non–Audited Financial Statements***

**Line 28. *Home Office Management or Other Departmental Cost Accounting Reports***

**Line 29. *Other (e.g. Home Country Regulatory Reports) (attach schedule):***

Attach a list of other documentation used to allocate and apportion deductions under section 1.861-8 (e.g., home country regulatory reports). Identify the type of documentation used whether its use is limited to identification of costs and deductions or whether it is used to determine allocations between departments or offices of the corporation.

**Part IV: Allocation and Apportionment of Deductions on Books and Records Used to Prepare Form 1120-F, Schedule L (Lines 30-42)**

Part IV of Schedule H (Form 1120-F) identifies the non-interest and non-bad debt deductions derived from the set(s) of books reportable on Form 1120-F, Schedule L and reports the allocations and apportionments to ECI and non-ECI under regulations section 1.861-8. Research and experimentation deductions that are subject to the allocation and apportionment rules under section 1.861-17 and charitable contributions recorded on the Schedule L books are also allocated and apportioned on Schedule H, Part IV.

**Line 30. *Total Expenses Per Books and Records used to Prepare Form 1120F, Schedule L***

Enter on line 30, the total expenses recorded on the profit and loss accounting derived from the set(s) of books used to prepared Form 1120-F, Schedule (“Schedule L books”). The expenses on the Schedule L books are those recorded under the corporation’s accounting practices and may be maintained in Generally Accepted Accounting Principles (“GAAP”) other than U.S. GAAP. **Note:** The Schedule L books may include set(s) of books of disregarded entities. See instructions to Schedule M-3 (Form 1120-F), line 5 for the Schedule L treatment of disregarded entities. The inclusion of such books applies equally to banks and non-banks for purposes of determining the expenses reportable on Schedule L, line 30.

**Line 31. *Adjustments for U.S. tax principles (attach schedule).*** Enter on line 31, the adjustments necessary to conform the expenses on line 30 to amounts characterized as deductions under U.S. tax principles. The deductions under U.S. tax principles are subject to allocation and apportionment between ECI and non-ECI. Attach a schedule identifying the amount of each type of the adjustment made to the amounts on line 30. See instructions to line 2 for a description of the types of temporary and permanent differences that are reportable as adjustments to the book expenses to conform the expenses to current year tax deductions under U.S. tax principles. Do not include interbranch expenses on line 31. Interbranch interest is adjusted specifically on line 33b and other interbranch expenses on the Schedule L books are reported on line 36, see below.

**Line 32. *Total deductions per line 30 books and records.*** Combine lines 30 and 31 and enter the amount on line 32. **Note:** the total deductions on line 32 are subject to further adjustment for interbranch interest and other interbranch expenses on lines 33b and 36, below. Other amounts that are characterizable as deductions under U.S. tax principles are adjusted from the line 32 pool of expenses on lines 33a, 34 and 35.

**Line 33a. *Third Party Interest Expense Per Books and Records***

Enter on line 33a, the amount of third-party interest expense (whether unrelated or related parties) on the Schedule L books. Interest expense is allocated and apportioned to ECI under regulations section 1.882-5. See Schedule I (Form 1120-F) and accompanying instructions.

**Line 33b. *Interbranch Interest Expense Per Books and Records***

Enter on line 32b, the interbranch interest expense recorded on the Schedule L books with other set(s) of books of the corporation that are not Schedule L books. Interbranch interest that is recorded between separate sets of Schedule L books is not includable in line 30. Interbranch interest is disregarded under section 1.882-5 and not includable in the interest expense allocation to ECI.

**Line 34. *Bad Debt Expense Per Books and Records***

Enter on line 34, bad debts included in line 32 total deductions that are deductible on Form 1120-F, Section II, line 15 or includible in the determination of the loan loss reserve of a small bank as defined under section 585.

**Line 35. *Other Third Party Expenses not Allocable under regulations section 1.861-8 (Attach Schedule)***

Enter on line 35, other third-party expenses on the Schedule L books that are not allocated and apportioned between ECI and non-ECI under section 1.861-8. Periodic expense from a notional principal contract is not allocable under section 1.861-8 if the amount is includible in the profits and losses of a global dealing operation and the corporation allocates and apportions such amounts under proposed regulations section 1.863-3(h). Such periodic expense included in line 30 should be adjusted on line 35.



**Line 36. *Less: Interbranch Expenses Per Books not Included on Line 33b (Attach Schedule)***

Report all interbranch expenses on the Schedule L books other than interbranch interest expense. The interbranch amounts reportable on line 36 include home office charges reflected on the Schedule L books for home office management services provided to the U.S. trade or business. **Note:** amounts paid or accrued on the Schedule L books to the home office are not determinative of the amount of expense allocable to ECI on Schedule H, Part II, line 21.

**Line 37. *Add lines 33a through 36***

Enter the amount on line 37. The amount on line 37 reflects the adjustments of interbranch expenses and third-party deductions included in line 32 that are necessary to determine the remaining pool of deductions eligible for allocation and apportionment under section 1.861-8.

**Line 38. *Deduction on Books and Records Allocable and Apportionable under Regulations Section 1.861-8***

Subtract 37 from line 32 and enter the amount on line 38. The deductions on line 38 are allocated and apportioned to ECI and non-ECI under section 1.861-8 and reconciled in lines 39 through 42, below.

**Reconciliation of Allocable Expenses on Books under Regulations Section 1.861-8 (from line 38) - Lines 39 through 42**

The deductions on line 38 are reconciled between ECI and non-ECI on lines 39 through 42 in three columns. Enter the ECI apportionments from line 38 in column (a) and the non-ECI apportionment in column (b). Add columns (a) and (b) for each line and enter the amount in column (c).

**Line 39. *Deductions Directly Allocated and Apportioned to ECI and non-ECI***

**Line 39a. *Derivative Transaction Deductions Directly Allocated under Section 861-8***

Enter on line 39a, derivative transaction deductions that are directly allocated and apportioned to ECI or non-ECI under section 1.861-8. Deductions includable on line 39a are periodic expense from notional principal contracts that are sourced under regulations section 1.863-7 with respect to hedging transactions or from securities trading and dealing operations. If notional principal contract periodic expense is allocated and apportioned under proposed global dealing regulations under Prop. Regulations section 1.863-3(h), such amounts should be adjusted on line 35 and are not subject to allocation and apportionment under section 1.861-8.

**Note:** periodic expenses from notional principal contracts may be allocable and apportionable to ECI and non-ECI in accordance with the ECI and non-ECI treatment of the item(s) the notional principal contract hedges.

**Line 39b. Other Deductions Directly Allocated under Section 1.861-8**

Enter on line 39b all other deductions included in line 38 that are directly allocated and apportioned to ECI and non-ECI under section 1.861-8.

**Line 40. Total Deductions Directly Allocated and Apportioned**

Add lines 39a and 39b, and enter the amount on line 40 for each column (a) through (c). The amounts on line 40 are the total deductions directly allocated and apportioned to ECI and non-ECI from the pool of deductions on line 38.

**Line 41. Deductions on books and records indirectly allocated and apportioned under Section 1.861-8**

Report on line 41 the deductions includable on line 38 that are allocated and apportioned to ECI and non-ECI under indirect methods. The total in column © must equal line 38 minus line 40, column (c).

**Line 42. Total Deductions Allocated and Apportioned Section 1.861-8**

Add lines 40 and 41 and enter the amount on line 42 for each column (a) through (c). The amount entered on line 42, column (a) is the total deduction from line 38 allocable to ECI that is includable on Form 1120-F, Section II. The total amount in Line 42, column (c) must equal line 38.

**Note:** Line 42, column (a) total are deductions reported on Form 1120F, Section II, in lines 12, 13, 14, 16, 17, 19, 20, 21, 22, 23, 24, 25 and 27.